Overview of the Financial Reporting and Auditing Regime in South Eastern European Countries

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Abstract: Since companies nowdays are going more and more cross border and becoming multinational, the adoption and implementation of International Financial Reporting (IFRS) and Auditing Standards (ISA) are as a result of globalization that has become a very important part of our world. In this regard lately, the accounting and auditing profession has undergone through major changes and developments. As part of these transformations were no different developing countries, since they are part of globalization as well. In this study, we present an outline of the financial reporting and auditing regime of countries in South Eastern Europe where as well we outline challenges faced by developing countries in adopting and implementing IFRSs and IASs. South Eastern European Countries such as Ex Yugoslavia countries face similar challenges and opportunities as part of their route to integrate and harmonize their financial and economic system with those of European Union, as a result of the same and unique characteristics of old and ex Yugoslavian system.Thus this study can help readers to have an overview of regulatory framework in these countries and to understand the similar and different challenges and opportunities, as well as it can serve as a base for a future research of the accounting and auditing professional developments in these countries. In this study, we present conclusions on why developing countries such as those that are part of this study choose to adopt international standards, and as well conclusions are drawn about the future of these standards for developing countries. Ongoing with the economic transition reforms undertaken within this region, financial reporting and auditing systems have been altered to converge with International Financial Reporting Standards, International Standards on Auditing, and towards a new emphasis on quality assurance for audit and external oversight mechanisms, to support the convergence process.

Keywords: International Financial Reporting Standards (IFRS); International Auditing Standards (IAS); Generaly Accepting Accounting Principles (GAAP); Financial reporting and auditing; European Union Directives, South Eastern European Countries

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1. Introduction

The internationalization of accounting and auditing profession has started since 1966 when a professional accounting bodies have begun to work on the road to set

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a globalized accounting standards. This was mostly a result of the financial global capital markets needs to greatly rely on “transparent, comparable and consistent financial information” in order to make ideal investment decisions.

The EU’s decision to adpopt IFRSs for the consolidated statements of listed companies since 2005, was followed by Australia in that year and Canada in 2011. China and Japan have also converged their financial reporting systems IFRSs.

In 2008, the US Securities and Exchange Commission (SEC) announced that it was considering adopting the IFRS from 2014 onwards. The US as a state which has so far rejected the adoption of the IFRS, since 2013 has begun the project for the harmonization and convergence of IFRS with American GAAP, thus affecting the spreading out of the use of IFRS throughout the world. In most cases (eg the EU and Australia), there are mechanisms to convert IFRSs (and its changes) into local legal requirements.

Based on international developments, this paper will give an overview the Regulatory Framework for financial reporting and auditing required by law in some of the countries including Montenegro, Macedonia, Serbia, Bosnia and Herzegovina, Kosovo and Albania.

Based on the data provided by member states of the Compliance Program of International Federation of Accountants (IFAC) and World Bank ROSC Report reviews for each country, we identify the key elements of the current reform efforts, outlining possible solutions, which may be relevant to these countries.

Overall, the weaknesses of state institutions are a characteristic of the transition economies of Central and South - Eastern Europe. (Bailey, 1995; Hegarty et al., 2004). In this way, “self-managed management” (Harding, 2000) for the accounting profession provides an appropriate policy choice for countries candidate for EU membership.

2. Literature Review

The literature review has highlighted the weaknesses of the efforts of the ex-socialist economies of Central and South-Eastern Europe during the implementation of the reforms, designed to stimulate economic development by creating an environment based on capital market, including requirements for reliable financial statements prepared in accordance with international standards. In this study we have reviewed the findings and reccomandations given by World Bank ROSC Report[1] as well taking into consideration the cultural factors, language barriers, historical development of the countries, wich of course have played a significant

[1] http://www.imf.org/external/NP/rosc/rosc.aspx.

role when walking towards the reforming of the systems with the best international practices. One of the most significant element of the above research is the lack of understanding of nature and the implementation of global standards. This is something that has been proven during these countries evolution of their path to the European system of market economies.

Another stream in the accounting literature examines issues of accounting harmonization. Models classifying countries (Nobes, 1992) or countries in transition, such as the extent of harmonization of a country's accounting standards, play a very important role in educating policy makers in different countries, but are far less important from the point of view of resolving the practical issues they face in countries that are committed to the implementation of the EU *Acquis Communitaire*. In a way, the Acquis has solved the problems with the choice of systems to be imported, but so far limiting choices for policy makers in existing EU countries.

While the international standards setting boards and committees take into consideration the needs of developed countries such as European countries, developing countries also have special needs that usualy are not considered by these boards, as is the case in the South Eastern European countries, that many of them have faced similar challenges during the transformation and harmonizing faze of their financial reporting and auditing systems with the requirements of European directives. However, even though a developing countries or countries in transition, their financial reporting and auditing systems are part of the international reporting frameworks and in these countries the implementation of international standards could serve as a bridge between local and foreign companies and at the same time will be a factor for attracting investors as mentioned in the literature review.

These studies describe the potential benefits and costs for investors from the implementation of IFRSs in Europe. Effectively, a country with low investor protection, legal enforcement, and low institution alignment with IFRSs may exhibit a higher level of profit management coupled with low relevance of IFRSs information compared to information according to local standards.

Consistent with these views, preliminary literature fails to consistently find significant market responses associated with previous efforts to harmonize financial reporting (eg, Joos & Lang 1994, Comprix et al., 2003). Në mënyrë konsistente me këto pikëpamje dualiste, literatura paraprake dështon që vazhdimisht të gjejë reagime signifikante të tregut të asociuara me përpjekjet e mëparshme për harmonizimin e raportimit financiar (for example Joos dhe Lang 1994, Comprix et al., 2003).

Choi and Levich (1991) argument that a single set of accounting and financial reporting standards enables comparison of financial statements between countries. Thus, potential investors are able to compare financial reports that are prepared according to the same standards (Larson, 1993). Tyrrall et. al. (2007) argue that the only set of accounting and financial reporting standards allow positive capital movements across borders and also lowers the cost of preparing financial statements.

Ashraf and Ghani (2005) emphasize that the adoption and implementation of IFRS in developing countries will improve the quality of standards as well as reduce the costs and timing of preparing financial statements. They also argue that adopting and implementing international standards will increase the efficiency of financial statements in stock markets, as the items in the financial statements will become more understandable to their users.

Since our study presents the financial reporting and auditing regime in many of the South Eastern European countries being part of ex Yugosllavian system, in the literature other studies are consistent with our topic of concern by studying former European Socialist countries that are in transition to the market economies of the Western countries.

For example, Bailey (1995) has found some mistakes in what policy makers take as assumptions, which explains why most countries have imported, amended, and adopted laws regarding the application of IFRSs to all types of enterprises:

• *Rearrangement of existing accounting regulations would have been sufficient;*

• *International Accounting Standards and European Union Directives are regulations;*

• *Accounting is practiced similarly in the developed world.*

The emphasis placed on other accounting and auditing studies in the South Eastern Europe region is the description of ways of evolving practices, regulatory mechanisms and occupations since the beginning of the transition period.

Daniel and others (2001) focused on Slovakia. Seal and others (1996) have explored the development of accounting profession in the Czech Republic, Brody and others (2005) provided a detailed description of recent accounting profession in Poland, and Sucher (2001) examines the issues that have to do with developing the concept of auditor independence in Russia.These studies reveal a typical evolution, beginning with the importation of standards and practices from EU countries, in most cases with donor assistance, translation difficulties, adoption in their current form of IFAC Codes and Standards and of the IASB, the impact of the achievement of the “Big 4 Firms” versus the background of the existing profession consisting of accountants who, in fact, were simply accountants under the previous regime.

Petrovic and Turk (1995) provide only a detailed description of the evolution of accounting practices and profession in Yugoslavia for the period up to 1992. An abbreviated version of this description is also compiled in the descriptive summary of Garrod and Turk (1995) concerning the developments in accounting regulations in Slovenia for the period from 1994.

3. International Standards - A Common Language for Setting and Harmonazing Financial Reporting and Auditing Frameworks

In the world of financial reporting and auditing, there is a debate over which country does not have the best standards, but finding ways in which alternative elements can be developed into a set of rigorous standards that reach international acceptance.

There are professionals and authors who question this approach and say that convergence is nothing more than negotiating and the final product of the convergence process is not technically the best standard but the product is a reflection of the negotiating powers of the parties in this process.

It is also shown that many states are not fully involved in the process and there is an imbalance of decision-making powers to influence the substantial part of the standards between the countries themselves. The other argument is that agreements can be reached on theoretical basis of accounting and auditing regulatory framework but convergence or negotiation is not needed. Overall, the process of convergence is a great challenge and its success is a result of a continuous compromise between the two powerful accounting boards - Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB).

In general, among the various authors, it is also concluded that the other important factor is the cultural impact to explain changes in the regulation of different countries. Accounting professionals and academics have studied and tried to explain how and to what extent the aspects of culture affect accounting and financial reporting regulations.

Although the above-mentioned factors have been significant in the past to explain the possible changes in the regulations, these differences recently fading from the ever-growing world economy needs. This is particularly true for multinational companies, for which it is a lot of hard work, difficult and costly to prepare financial statements for different countries where they have branches or they do operate.Consequently, a common language of financial reporting and auditing will impact on business facilities and reliable and comparable reports for companies that make cross-border businesses and of course for their partners.

In order for international capital markets to operate efficiently and effectively, international standards are essential. The entire business community and users of accounting information should be able to communicate effectively and without any barriers.

4. Developments in European Union in Relation to IFRSs, based on Acuis Communautaire's Requirements and Relevant EUdirectives

International requirements for financial reporting and auditing have become more complex and rigorous recently, while at the same time the EU *Acquis Communautaire* has significantly evolved, especially in recent years.

In such an international regulatory environment so dynamic, the national financial reporting and auditing requirements can be made very quickly non-compliant with the acquis requirements. Particularly the following issues need to be addressed by the policy makers in developing countries of South Eastern Europe: preparation of management reports, half-yearly reporting for listed companies, electronic publication of financial statements, approval and registration of audit firms, and preparation of consolidated financial statements.

In Accounting and Auditing field, the main elements of the acquis are the Fourth, Seventh and Eighth Companies Directive, the European Commission Regulation on the Implementation of IFRSs for Registered Entities and the Recommendations on Audit Quality Assurance.

When the EC adopted IFRSs for listed companies within the European Union, at the same time, it established a process of supporting the standard setting within the Commission, whereby the Commission could support the "approval" of IFRSs to be used in the EU. To date, the EU has adopted most of the IFRSs, with the exception of paragraphs of a small number of IFRSs that relate to financial instruments.

Beginning from January 1, 2005, all European Union (EU) companies, which have shares listed on the stock exchange, are required to prepare consolidated PFs in accordance with IFRS. Companies that have issued debt securities but not equity stocks have been allowed to not prepare their FS with IFRS since 2005, but such a thing has been demanded from 2007 onwards.

In addition to the consolidated statements of publicly traded companies governed by EU law, each EU country has the right to allow or require other companies to prepare their consolidated and / or annual financial statements in accordance with IFRS. In order to strengthen and extend the use of IFRS in most EU countries, in 2003 the Committee of European Securities Regulators (CESR) issued two standards that should be implemented by the European Union's regulators.

The first CESR standard sets out 21 basic principles in order to be applicable to the publication of financial information by listed companies.

The second CESR standard aims to coordinate implementation activities across the European Union. This includes the exchange of information on various issues and a database of decisions taken by the standard readers and empowerers of the member states.

The effect of the transition to IFRS has changed from country to country and from one company to another. Local standards in many European countries have been developed to serve or assist reporting for other tax regulatory purposes and thus the principles differ from country to country.

5. Financial Reporting and Auditing Regime in Eastern European Countries

Differences between accounting, financial reporting and auditing standards between different countries are caused by economic and political changes (Nobes, 1998). Moreover, other studies show that cultural differences, based on the Hofstede model, are the main reasons for the changes in the above-mentioned standards (Salter & Niswander, 1995; Chanchani & Willett, 2004). In addition, Chamisa (2000) points out that the needs and requirements for accounting and financial reporting of countries are the main drivers for the establishment of accounting standards in different countries, so it points out that emerging economies have a greater variety of economic factors and social than developed countries.

For example, Zeghal and Mhedhbi (2006) show that education is one of the important factors affecting accounting and financial reporting standards. They show that many developing countries base their education system in accounting and auditing in one of the developed countries like the United Kingdom and the United States.

Moreover, Yapa (2003) shows that most developing countries such as Malaysia and Indonesia have invasion of education systems from developed countries, which are often unable to produce adequate capacity to meet their accounting needs and financial reporting of these countries.

Perera (1989a) argues that information produced by the accounting and financial reporting standards of developed countries will not provide useful information to make decisions in developing countries.

Below we present a summary of a financial reporting and auditing system in some of the South Eastern European Countries such as Montenegro, Bosnia & Hercegovina, Serbia, Macedonia, Albania and Kosovo.

5.1. Financial Reporting and Auditing System in Montenegro

The accounting, auditing, and financial reporting framework for legal entities within Montenegro is defined by the Law on Business Organization of 2002, the Law on Accounting No. 052 of 2016, and the Law on Auditing No. 001 of 2017. The Accounting and Auditing Law requires all companies to prepare and publish financial statements in accordance with IFRS six months after the end of the financial year. The Decree No. 33/10 recognizes the Institute of Certified Accountants of Montenegro (ICAM) as the competent authority for accounting and auditing activities.

The law included a list of specific IFRSs and envisaged that Institute of Certified Accountants of Montenegro (ICAM) will approve and publish the subsequent IFRSs. The law has included an exemption option for entities with a turnover of less than € 500,000 which may use accrual accounting or cash based accounting. The law "delegated" to the ICAM regulatory authority the following public duties: to develop additional accounting standards and guidelines; develop model forms of financial statements for legal entities (in accordance with IAS); to issue simplified accounting regulations for SMEs; approve and publish the ISA; to determine the education and work experience for certification of accountants, accountants and auditors; and provide training for accountants and auditors and maintain a register of accountants and auditors.

Instead of referring to ICAM as a body with delegated regulatory powers, the new law is referred to as a "competent body"which will adopt and publish the IFRS. Consequently, the existing regulatory structure lacks the basic "IFRS" fundamentals for the preparation of financial statements. In practice, the Serbian-language translation of IFRSs is widely used (Pervan, Horak & Vasilj, 2010).

The new law requires that all legal entities (around 14,400 entities) in Montenegro use IFRSs for preparing annual financial statements. It was also envisaged official approval and publication of properly translated ISAs to complete the regulatory structure.

5.2. Financial Reporting and Auditing System in Bosnia and Herzegovina

Since 2004, Bosnia and Herzegovina have adopted a mechanism for harmonizing laws and accounting and auditing regulations, through the adoption of the Legal Accounting and Auditing Structure and the parallel approval of the Accounting and Auditing Laws by the Governments of both countries.The BiH Law No. 42/04 requires application of IFRS or IFRS for SMEs, based on entity size, for the preparation of financial statements.

In Federation of BiH, the Law on Accounting and Auditing of the FBiH of 2009 (FBiH A&A Law 2009) establishes the requirements for accounting and auditing. According to the 2009 Legal Framework: Accounting Standards for use in Bosnia and Herzegovina are IFRSs and IASs issued by the International Accounting Standards Board (IASB), including the implementation guide and interpretations. Audit Standards for use are ISAs issued by the International Bureau for Auditing and Security Standards (BNSAS). In addition to small enterprises, all enterprises are required to be audited, including companies that have listed securities on the stock exchange, banks and insurance companies. Small companies may choose to audit their financial statements, but this is not mandatory.

5.3. Financial Reporting and Auditing System in Macedonia

In Macedonia substantial efforts have been made since 2003 to reform the legal framework for accounting and auditing. The government has made reforms that are in line with best international practices and acquis communautaire. Major changes in accounting since 2003 include: adoption of a bill on accounting services; the adoption of relatively recent versions of the IFRS; for the presentation of the IFRS for SMEs; improved mechanisms for presenting financial statements; and increased transparency through the availability of data in the Central Registry.

Additional audit reforms include: adopting a new audit law; establishment of a professional institution for statutory auditors; preparation of the agreed certification curriculum; replacing old audit standards with new versions, and establishing quality

The Trade Companies Law of 2004 establishes the fundamental requirements of financial reporting and auditing, applicable to all companies in Macedonia. Large and public-sized companies apply IFRSs and all small business organizations in Macedonia, including micro-enterprises, are required to apply IFRS for SMEs.

FYR Macedonia is in the early stages of putting in place a modern disclosure regime that is complied with by the listed sector. IFRS is now required for listed companies, but evidence suggests that many companies are only beginning their transition[1].

Another legal framework is The Audit Law of 2010 which recognized the Council for Advancement and Oversight of Auditing (CAOA) with a mandate to perform independent public oversight of the audit profession.

The principal duties of CAOA detailed in Article 8 of the Audit Law of 2010 include: (i) issuing licenses to practice auditing; (ii) overseeing the work of the Institute of Certified Auditors of Republic of Macedonia (ICARM); and (iii) may investigate and discipline auditors where necessary.

Companies, with the exception of small and micro-enterprises, should audit from an external auditor the entity's annual financial statements and the consolidated financial statements.

5.4. Financial Reporting and Auditing System in Serbia

In 2013 Serbia have introduced the new legislation to improve the accounting, auditing, and financial reporting framework in order to be in line with the relevant EU Directives. The Law on Accounting of 2013 stipulates the requirements for the

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[1] http://documents.worldbank.org/curated/en/779541468271519505/pdf/350990MK0REV0Corporate0ROSC1CG1FYRM.pdf.

preparation of financial statements, including applicable accounting standards and financial reporting thresholds.This law applies to all enterprises, banks, insurance companies, and other financial organizations as well as sole proprietorships. The law requires that all enterprises, ranging from the largest listed company to the only smaller ownership, should comply with IFRSs.

The Law on Auditing of 2013 defines the scope of the entities subject to mandatory audit requirements, and establishes the Audit Public Oversight Board of Serbia.

Under the Law on Auditing, all large and medium-sized entities, financial institutions, public entities established under the Capital Markets Law, and sole proprietors that generate income in excess of €4.4 million in the previous financial year must have an audit of the financial statements[1].

This law requires statutory audits to be conducted in accordance with the ISA, and the Code of Ethics for Professional Accountants of the International Federation of Accountants (IFAC).

This law as well regulates the profession in Serbia, where only auditors are regulated at the state level under the Law on Auditing of 2013. The profession is regulated by the Chamber of Authorized Auditors of Serbia (KoR) under oversight of the Ministry of Finance (MoF) and the Audit Public Oversight Board (APOB).

5.5. Financial Reporting and Auditing System in Albania

After the '90s, the accounting/audit laws in Albania were drafted and adopted, taking into account in the first instance the requirements of Western legislation and the experiences of other Eastern European countries, similar to Albania, which were also going through a transition stage.

One of the most important and early steps in the reform of the accounting and auditing profession was the adoption in 1993 of the "Accounting Law", in which the general obligations, accounting principles and rules, preparation and presentation of financial statements for the time the first were defined in detail (Shkurti & Leka, 2010).

Law No. 9228 of 2004 on Accounting and Financial Statements determines the financial reporting requirements applicable in Albania.

Listed enterprises and public interest entities such as banks, insurance companies, securities funds when they are not listed on a stock exchange apply to the IFRS. Other companies use National Accounting Standards.

The audit profession is regulated by the 2009 Law which was updated in 2016 on Legal Auditing, the organization of the profession of registered accounting expert

[1] https://www.ifac.org/about-ifac/membership/country/serbia-republic.

and approved accountant. The amendments to the Law No. 10091 introduced in 2016 reviewed some of the requirements related to the audit profession and the role of the Professional Accounting Organisation of statutory auditors. This Law states the requirements to enter the audit profession and to register auditors and audit firms and requires the adoption of ISA as translated in Albanian.

The Law on Business Organizations defines annual audit requirements for all companies except small ones.

5.6. Financial Reporting and Auditing System in Kosovo

Initially Regulation 2001/30 on the Establishment of the Kosovo Financial Reporting Standards Board (BKSRF) and then the Law on Accounting, Financial Reporting and Auditing - Law no. 06/L-032 on Accounting, Financial Reporting and Auditing, which was published in 2018 and which repeals the previous law - Law no. 04/l-014 on Accounting, Financial Reporting and Auditing, established the regulatory framework for accounting, financial reporting and auditing in Kosovo. Current law aims to implement the EU acquis communautaire in accounting and auditing, and provides a legal basis for the implementation of EU directives.

According to the World Bank's ROSC report, the structure is appropriate but is not functioning effectively. Thus, limited technical and financial resources have emerged, and institutional weaknesses in some areas. The proposed changes to the laws are aimed at improving the existing framework by strengthening oversight of the accounting and auditing profession and clarifying the roles and responsibilities of regulatory institutions.Kosovo Financial Reporting Council under the Ministry of Finance is the regulatory oversight body overseeing the accounting and auditing profession but also the reporting of businesses.

Until September 2011 financial reporting framework in Kosovo for business entities excluding financial institutions has included the national standards-Kosovo Accounting Standards issued by KBSFR, the predecessor of the KCFR. The Law on Accounting, Financial Reporting and Auditing replaced KAS with IAS/IFRS. KCFR also issued Administrative Instructions on "Implementations of IFRS for Small and Medium Enterprise" to be applied for reporting periods beginning on 01 January 2015. Article 5 of the Law on Accounting, Financial Reporting and Audit requires large, medium & small business organizations in Kosovo registered as limited liability companies or shareholder companies, to apply IASs/IFRSs as well as interpretations, recommendations and necessary guidance as issued by International Accounting Standard Board.

So, IFRSs are the reporting framework for large and public interest entities, while small and medium-sized enterprises should report to IFRS for SMEs, whereas microenterprises report under the framework established by the Kosovo Financial Reporting Council. Based on the Law KCFR adopts all standards and pronouncements issued by the IAASB relating to audits of historical financial information (financial statements). According to the requirements of the law statutory audit according to ISAs is required for large and medium-sized enterprises.

6. Conclusion

At international level, standards improve transparency. They identify the weak points, the prevention and avoidance of which can contribute to economic and financial development. They enhance market efficiency and discipline. At national level, standards offer benchmarks to identify the weak points in question and guide policy makers for necessary policy reforms. To better serve these two objectives effectively, the purpose and implementation of such standards should be assessed from the context of the overall economic environment, development and a country's strategy and thus should be adjusted to the individual circumstances of the countries environment, especially for developing countries where there are no necessary resources available to implement and adopt high quality and costly standards.

In this regard, (Berkowitz et al., 2003) suggests that only the application of high quality financial reporting standards such as IFRSs is not sufficient to improve the quality of accounting and financial reporting information, while there are no state and institutional mechanisms that empower the implementation of IFRSs and while companies themselves have no benefits and incentives that exceed costs to provide high quality information to the stakeholders.

Such as (Ball et al, 2003; Berkowitz et al., 2003; Ball, 2001), which suggest that only the adoption of high quality financial reporting standards such as IFRSs is not sufficient to improve the quality of accounting and financial reporting information, while there are no state and institutional mechanisms that empower the implementation of IFRSs and while companies themselves have no benefits and incentives that exceed costs to provide high quality information to the stakeholders.

This phenomenon is of great importance also to those countries which we have analyzed in this study, because all of them in one way or another faces a lower level of institutional oversight for the proper implementation of the international standards.

The key and common part of the economies of the South and Eastern European countries is that their legal frameworks do include international standards, but they are not applied fully, and in some cases the requirements of these standards are very scarce to be implemented (from the aspect of financial resources, human resources, training resources, and other additional costs) from all of these countries.

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